Calendar No. 878

98TH CONGRESS
2d Session

SENATE

REPORT 98-452
98-452

A BILL TO AMEND THE SMALL BUSINESS ACT

MAY 16 (legislative day, MAY 14), 1984.—Ordered to be printed

Mr. WEICKER, from the Committee on Small Business, submitted the following

REPORT

[To accompany S. 2069]

The Committee on Small Business, to which was referred the bill (S. 2069) to amend section 7(a)(3) of the Small Business Act to provide that financings provided to State and local development companies pursuant to Title V of the Small Business Investment Act of 1958 shall not be considered when computing the total amount outstanding and committed to a borrower from the business loan and investment fund under the Small Business Act, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. COMMITTEE CONSIDERATION

S. 2069 was introduced by Senator Larry Pressler on November 8, 1983 and referred to this Committee. This bill proposes an amendment to the Small Business Act which would insure that financings to State and local development companies under Sections 502 and 503 of the Small Business Investment Act of 1958 would not be considered when computing the total amount of financing available to an eligible small business borrower under Section 7(a) of the Small Business Act. In other words, the amendment would permit the combination of sections 502 and 503 development company loans with section 7(a) loans in excess of the current $500,000 maximum loan limitation. This amendment would overturn SBA's recently adopted policy, which reversed an eight year old agency policy that permitted such combination loans in excess of $500,000.

On May 1, 1984, Senator Pressler chaired a full Committee hearing on this bill. The Committee received testimony from Edwin Holloway, Associate Administrator for Finance and Investment for

the Small Business Administration (SBA); representatives of three SBA 503 Certified Development Companies (CDC's): William Folkerts, Treasurer of First District Development Company, Watertown, South Dakota; Evelyn Beale, Secretary/Business Finance Representative for the Milwaukee Economic Development Corporatin, Milwaukee, Wisconsin; and Arthur Goodman, President of the San Diego County Local Development Corporation, San Diego, California. The Committee also heard from Leroy Hagenbuch, President of Phillippi-Hagenbuch, Inc., a small business manufacturer in Peoria, Illinois.

All of the witnesses at the hearing testified in support of the legislation, pointing out that under the current SBA Policy significant job generating projects would be lost and the overall objectives of the 503 program could be frustrated. The private sector witnesses urged the Committee to quickly adopt the bill to reinstate SBA's previous practice which permitted an eligible and qualified small business concern to receive up to $500,000 in financings under each program, that is up to $1 million.

On May 8, 1984, the Committee met in executive session and, with quorum present, ordered S. 2069 favorably reported without amendment. The Committee bill, as reported is as follows:

> That section 7(a)(3) of the Small Business Act is amended by inserting before the period at the end thereof the following: ": *Provided further,* That financings provided under this subsection to State and local development companies pursuant to title V of the Small Business Investment Act of 1958 shall not be considered when computing the total amount outstanding and committed to a borrower from the business loan and investment fund established by this Act".

II. Legislative History

A. BACKGROUND

The Small Business Administration's 503 Certified Development Company Program was enacted on July 2, 1980, as a part of P.L. 96–302. The purpose of the program is to leverage the SBA guarantee to encourage financial institutions to make long-term capital available to small businesses on reasonable terms in order to create and retain jobs in local communities. Section 503 of the Small Business Investment Act of 1958 was designed to make SBA an active partner with state and local governments and the private sector. Without Federal guarantee programs such as that provided by the 503 program, banks are often reluctant to make such loans to small companies.

Under the sector 503 program, SBA is authorized to guarantee debentures issued by certified development companies (CDC's) to finance the purchase of land, plant and equipment (i.e., fixed assets), for an identifiable small business concern. By law, SBA's guarantee can be for as much as 50 percent of a project's cost, up to a maximum of $500,000. By regulation, however, SBA has established its share of the project's cost at not to exceed 40 percent. The remaining 60 percent must come from the private sector, usually 50 per-

cent from the bank and 10 percent from the CDC or the small business concern. Maturities on these loans can be for up to 25 years. The creation or retention of a substantial number of jobs is also a regulatory requirement before any such loan can be guaranteed by SBA under the 503 program.

Congress intended that 503 CDC's would be permanent entities, active in local economic development, and have the ability to provide small businesses with a full range of financial and managerial services. In order to be certified under the 503 Program, a local development company must have an active board of directors whose members represent the political and financial sectors of the community, a full-time professional staff, and the capability to provide legal, accounting and business advisory services.

Prior to the enactment of the 503 Certified Development Company Program, SBA was authorized to make direct and guaranteed loans to local development companies for "bricks and mortar" financing under section 502 of the Small Business Investment Act of 1958. Under the 502 program, development companies can make loans to small business concerns for the same purposes as under the 503 program, i.e., to purchase land, to acquire or construct a new plant, or to convert or expand the firm's existing plant. Like the 503 program, the maximum amount of financing available for a 502 loan is $500,000 and the maturity on a loan can be for up to 25 years. After enactment of the 503 program, many 502 local development companies began making the transition to becoming certified under the 503 program. During this transition, certified development companies continue to participate in the 502 program when project opportunities and funds are available.

Since its enactment, the 503 program has become the SBA's premier program for promoting local economic development. However, CDC's have continued to use the 502 guarantee program where 503 financing has proven unworkable. Both programs are designed to meet small business' critical need for affordable, long-term capital for fixed asset financing in order to expand and create new jobs. CDC's have found that these two programs compliment, rather than compete with each other. Where CDC's have determined that utilization of debenture financing through the 503 program has not been available, the 502 loan program has presented another viable alternative.

Under section 7(a) of the Small Business Act, the agency's regular business loan program, SBA is authorized to make and to guarantee loans to small business concerns for any business purpose, including for working capital. The maximum 7(a) loan amount which can be outstanding to a small business concern is $500,000.

Under the SBA's current policy, it is possible for a small business concern to receive a 502 or 503 development company loan for fixed assets and a 7(a) regular business loan for working capital. Such companion loans are not possible, however, if the combined total of the loans exceeds $500.000.

For the past eight years, first under the 502 program and then later under both the 502 and 503 programs, it has been SBA's policy to permit eligible small business concerns to receive up to the maximum loan amount of $500,000 under either the 502 or the 503 program, and to permit these loans to be combined with loans

granted by SBA under the 7(a) regular business loan program for a maximum, combined total financing of up to $1 million. This permissible combination has proven particularly beneficial to many small businesses needing working capital assistance, which is available only through the 7(a) loan program, to help finance business expansion or plant modernization.

Under Public Law 97-35, the Reconciliation and Loan Consolidation Act of 1981, several SBA loan programs were consolidated into section 7 of the Small Business Act, which contains most of the Agency's non-disaster lending programs. This action was taken at the Agency's request in order to facilitate the Agency's administration of its several loan programs, standardize the terms and conditions of current programs and discard obsolete programs. Although the statutory program authority for development company loans is found in Title V of the Small Business Investment Act of 1958, the authority to fund Title V programs was specifically incorporated into section 7 of the Small Business Act by the 1981 law. When Congress consolidated these programs, there was no discussion or intention that this action would overrule the SBA's policy or permitting the combination of development company and regular business loans over $500,000. However, on December 20, 1983 SBA issued the following notice to its field officers:

SMALL BUSINESS ADMINISTRATION NOTICE

To: Regional Administrators, District Directors, Branch Managers.
From: Edwin T. Holloway, Associate Administrator for Finance and Investment
Subject: Companion 7(a) Loans with Development Company Assistance.

This notice addresses the past practice of a small business concern receiving a 502 or 503 loan (Development Company Loan) and a working capital or machinery and equipment loan under the regular business loan program (7a loan program).

It has been determined that The Small Business budget Reconciliation and Loan Consolidation Improvement Act of 1981 (PL 97-35) precludes that practice in the Development Company and 7(a) Programs *if* the *combined* amount outstanding to a single small business concern would exceed $500,000.

This change combined the authority for several of the loan guarantee programs for ease of administration. Authority for the Development Company Loan Programs was incorporated under the 7(a) statute by Section 1902(13) of the Act, which states:

"The Administration may provide financings under this subsection to State and local development companies for the purposes of, and subject to the restrictions in, title V of the Small Business Investment Act of 1958."

Section 7(a)(13) of the Small Business Act limits the amount of assistance to an identifiable concern as follows:

"No loan under this subsection shall be made if the total amount outstanding and committed (by participation or otherwise) to the borrower from the Business Loan and Investment Fund established by this Act would exceed $500,000. . . ."

Since the small business concern is the borrower, the effect on an individual small business is to limit the *combined* amount of assistance it can receive from Development Company and 7(a) Programs to $500,000.

Therefore, effective immediately no loans are to be approved under Section 7(a) of the Small Business Act where the total amount outstanding and committed (SBA share) from the Business Loan and Investment Fund to a single borrower would exceed $500,000. This includes both regular loan programs and Development Company Loan Programs. Loans that have already been approved may be funded pursuant to the terms of the loan authorization.

If you have any questions concerning this matter, please contact Charles Hertzberg or Wayne Foren in the Central Office.

Even before the official notice was issued, the Committee had been contacted by some CDC's which had projects in progress whose combination financing in excess of $500,000 was threatened by the impending change in the Agency's policy. On November 8, 1983, Senator Pressler introduced S.2069 to clarify the congressional intent and to correct the unintended consequences resulting from the enactment of Public Law 97-35.

B. NEED FOR LEGISLATION AND COMMITTEE HEARINGS

SBA began certifying CDCs in late 1980. As of December 31, 1983, 470 had been certified. Another 50 applications were pending nationwide. A number of these development companies are just getting off the ground, but 323 of them had already been involved in at least one financing by the end of 1983 and 236 of them had made more than one loan. All told, 2,239 loans had already been made under the program.

The 40 percent of the project costs guaranteed by the SBA for these 2,239 loans totalled $45.5 million. According to SBA, by December 31, 1983, about 45,000 documented jobs had been created or retained as a result of 503 loans, with an average SBA investment per job of less than $10,000. The vast majority of the jobs created are permanent jobs in the manufacturing and wholesale/retail industries. In every quarter since the creation of the 503 program, more and more jobs are created and the Federal commitment per job declines. Section 503 is a classic example of a Federal jobs program that works, and works well.

The key to the 503 program is the certified development company. CDC's market the program to local banks and small businesses and put together the loan packages. Testifying before the Committee in 1983, James Sanders, Administrator of the SBA, spoke of the role of CDC's in the following terms:

> The role of the certified development company is to be a catalyst in economic development and to marshal the resources necessary to complete economic development projects, combining resources from both the public and private sector. These projects are designed to create or retain a meaningful number of jobs in the communities affected, with a special emphasis on distressed areas.

To carry out that role as catalysts to the fullest extent possible, CDC's must have available, and must use, many different kinds of financial tools. As William Folkerts, of the First District Development Company, a CDC in Watertown, South Dakota said at the Committee's hearing on S. 2069:

> [CDC's] have to have flexibility in the Federal loan programs to fit the needs of business and industry that want to expand and that will create the new jobs . . . each business and industry is different, [and each] has different financial needs.

Mr. Folkerts testified that this flexibility is particularly important for CDC's in areas such as rural South Dakota where the dominant agricultural industry has suffered greatly and "the young, talented, productive members of the labor force" must move to other areas to find jobs.

At this hearing on S. 2069, the Committee heard from CDC's from very different areas of the country. The geographical and demographic differences, as well as the examples they cited of projects involving combined 7(a) and 502/503 financing, illustrate the CDC's need to have flexibility in order to promote economic development. As an example, Mr. Folkerts cited the case of Twin City Fan and Blower Company, a $2.9 million project. In the city of Brookings, South Dakota, where the popluation is only 16,000, the Twin City project will employ 160 people within two years. According to Mr. Folkerts, the Twin City project would have been lost without the availability of the $500,000 obtained through the 503 program to construct the building and a $500,000 section 7(a) loan for equipment and working capital. (Although there was one other South Dakota Development Company project which might have used similar companion financing, the company's credit rating permitted it to get working capital from sources other than SBA.]

Frequently, small businesses which need capital to purchase fixed assets to expand their physical plant will also need working capital to purchase additional equipment and inventory, to pay new employees, and to finance accounts receivable. Indeed, providing working capital may be essential to make the projects workable, and ultimately may ensure that the business will be successful. Certainly not all projects involving 503 financing will need Federal funding for working capital, however.

Testifying in support of the bill, the SBA pointed out that only 5 or 6 percent of the total amount of their section 7(a) loans are in excess of $400,000. Furthermore, according to Ed Holloway, SBA's Associate Administrator for Finance and Investment, "only 98 small business concerns had received companion loans that exceeded the $500,000 in the aggregate, out of 2,230 loans that had been approved" up until last December. As of that time, only 13 more loans were pending approval. Therefore, in Mr. Holloway's opinion, S. 2069 would not place any more demand on program funding levels for development company or 7(a) loans. Rather, he testified "such impact would only result in a reallocation, among several concerns, of loan guarantees."

Another witness at the hearing, Ms. Evelyn Beale of the Milwaukee Economic Development Corporation (MEDC), indicated that the

availability of companion financing has been a very valuable asset, possibly as important as the 503 program itself. Ms. Beale stated that in Milwaukee, banks had come to rely on the availability of companion loans, especially the combination of 502 and 7(a) loans. Of the ten projects she identified, where the $500,000 limitation had been an issue, nine of those projects involved the combination of section 502 and 7(a) loans. Ms. Beale supplied the Committee with the following list of projects and their corresponding number of affected jobs:

TABLE 1.—TANDEM FINANCED PROJECTS

Companies	Project description	Total investment	SBA	Job impact	
				Jobs before	New/ retained
Airsan Corp.[1]	Acquisition of building and equipment; inventory and working capital.	$1,464,250	502/7a	32	34
Graphic, Inc.	Building expansion, equipment	940,000	502/7a	32	5
VIR Corp./Lippman Industries	Plant acquisition, remodeling; working capital refinancing.	3,085,000	502/7a	30	70
Globe Limited [1]	Purchase land, building, equipment inventory, receivables; working capital.	1,270,000	502/7a	18	2
Waukesha Wholesale Foods	Purchase business assests, expansion, equipment and working capital.	4,100,000	502/7a	43	20
Ziegler Tanning	Machinery, equipment, working capital	1,797,000	503/7a		24
Gala Tool & Die Co.	Equipment, refinancing, working capital	1,138,600	502/7a	40	20
E. P. Hoyer [1]	Purchase building, equipment, working capital.	2,305,000	502/7a	50	[2] 50
Snider Mold [1]	Business assets, equipment, working capital.	1,330,000	502/7a	18	2
Applied Bio-Chemists [3]	Site acquisition, building construction, remodling, equipment.	870,082	502/a	65	25

[1] Leveraged buyouts.
[2] Retained.
[3] Submitted as 502/7a—was restructed to 502 and direct term loan from the bank after Dec. 20, 1983.

In Ms. Beale's judgment, none of these projects would have been possible under SBA's current companion loan policy. As the table denotes, four of the projects involved a "leverage buyout", situations where the managers of a company joined together to buy-out the company, or a subsidiary of the parent corporation. Without the companion financing, the city of Milwaukee would have lost those jobs when the companies moved out.

The current SBA policy not only inhibits job creation on the larger projects which involve the maximum 502 or 503 loan amounts, but it also adversely impacts growing small businesses which have previously received and continue to have outstanding, SBA assistance under the 7(a) program. Testimony from two witnesses at the Committee's hearing illustrated this point.

First, Arthur Goodman, President of the San Diego County Local Development Corporation, one of the top producing CDC's in total 503 loans, and 503 loans to minority businesses, gave the following example:

> The small business' first 7(a) loan was $100,000. He employed his fiancee and two minority woodworkers. We worked this firm up through 2 additional 7(a) loans until he used his $500,000 limit. At the time of the second 7(a)

loan he also purchased his own building under the 503 program. This firm has gone from 2 employees—and a fiancee—to a husband and wife and over 100 employees.

Of the 100 employees, 82 were hired from Federally funded programs. If the $500,000 limit existed at the time this project was financed, there would not have been the third level of expansion and 40 jobs would not have been created, Goodman said.

Leroy Hagenbuch of Phillippi-Hagenbuch, Inc. of Peoria, Illinois, a small business designer and manufacturer of specialized haulage accessories for off-highway mining trucks, also emphasized the dilemma the current policy poses for growing small businesses. Mr. Hagenbuch needed funds to build a new fabrication facility, to refinance an office building that he had built two years earlier on short-term bank loans, and to develop more products. Mr. Hagenbuch testified that he had first sought financing from two banks and several insurance companies, without success, before visiting the Peoria Economic Development Agency (PEDA), a CDC that was able to provide him with the necessary capital at reasonable terms. His total project cost was $1.2 million, of which $275,000 came from a 503 debenture to finance the fabrication facility, and $500,000 came from a 7(a) loan which was used for product development, working capital and the refinancing of his office building. Under the current SBA policy, Mr. Hagenbuch's project would not have been possible. Furthermore, now that he has reached the $500,000 limitation, he will be precluded from receiving any more financial assistance from SBA, regardless of need, ability to repay or jobs to be created.

At the Committee hearing Senator Pressler questioned SBA about an alternative approach of raising the overall limit on the amount of 7(a) loans to one million dollars. Mr. Holloway responded that he believed the agency would have to oppose that approach because of the budgetary impact that it might have. The Committee agrees. Furthermore, the Committee believes that the separate and distinct program purposes are best served by retaining the various programs at SBA. Permitting the combination of 502/503 loans with 7(a) loans, as S. 2069 would do, is the preferable approach. it maintains the distinct nature of the various programs and has worked well to meet the needs of small businesses.

CONCLUSION

Section 503 Certified Development Companies are emerging as a major force in local economic development. To realize their fullest potential, CDC's should continue to have the flexibility to choose among Federal financial assistance programs to meet differing needs and circumstances of expanding small businesses. In addition to the 503 program, CDC's have effectively used the SBA section 502 and 7(a) loan programs to provide fixed asset financing and working capital, respectively. SBA's prior practice provided the necessary flexibility to meet the country's pressing need for jobs. The present policy only thwarts and frustrates these objectives. Furthermore, the present policy may serve as an obstacle for small businesses that have traditionally relied on receiving SBA assistance under the 7(a) program, from using the 503 program at the

very time that they most need it to expand. The Committee believes that S. 2069 would properly reverse the current counter-productive policy without additional funding demands.

III. Section-by-Section

Analysis

The Committee bill consists of one section. It amends section 7(a)(3) of the Small Business Act to provide that development company loans under Title V of the Small Business Investment Act of 1958 shall not be included when computing the maximum amount of financial assistance made available to a small business concern under section 7(a) of the Small Business Act.

IV. Matters Required To Be Discussed Under Senate Rules

A. Committee Vote

In compliance with rule XXVI(7)(c) of the Standing Rules of the Senate, the Committee voted to report out this legislation. The following roll call votes were recorded:

YEAS (16)	NAYS (0)
Weicker	
Packwood [1]	
Hatch [1]	
Boschwitz	
Gorton [1]	
Rudman	
D'Amato [1]	
Kasten [1]	
Pressler [1]	
Nunn	
Huddleston [1]	
Sasser [1]	
Baucus [1]	
Levin [1]	
Tsongas	
Dixon	

[1] Indicates vote by proxy.

B. Cost of the Legislation

In compliance with Rule XXVI of the Standing Rules of the Senate, the Committee estimates that the cost of the legislation will be equal to the amounts indicated by the Congressional Budget Office in the following letter:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, D.C., May 9, 1984.

Hon. LOWELL P. WEICKER, JR.,
Chairman, Committee on Small Business, U.S. Senate, 428A Russell Senate Office Building, Washington, D.C. 20510

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 2069, a bill to amend the Small Business Act, as ordered reported by the Senate Committee on Small Business, May 8, 1984. We expect that enactment of S. 2069 will have no cost to federal, state or local governments.

S. 2069 would exclude development company loans from the computation of the maximum amount available to a small business under Section 7(a) of the Small Business Act. Under current law, if a company receives a development company loan for the maximum amount of $500,000, it would not be eligible to receive additional assistance from the Section 7(a) loan programs administered by the Small Business Administration (SBA). Similarly, a company receiving Section 7(a) assistance would have its development company financing limited by the amount of the outstanding Section 7(a) loan.

While S. 2069 would allow a particular small business to receive financing up to $1 million rather than the current level of $500,000, the bill would not authorize an increase in the SBA program levels or any additional appropriations for this purpose. Thus, S. 2069 would make possible a different allocation of existing loan funds, but would not require any new funding. If loan demand increases as a result of this provision, however, the Congress may respond by authorizing and appropriating additional resources for SBA loan programs.

If you wish further details on this estimate, we will be pleased to provide them.

Sincerely,

ERIC HANUSHEK
(For Rudolph G. Penner).

C. REGULATORY IMPACT STATEMENT

In compliance with rule XXVI(11)(b) of the Standing Rules of the Senate, it is the opinion of the Committee that no significant additional regulatory impact would be incurred in carrying out the provisions of the legislation. Nor does the Committee believe that the bill would have any additional impact on the privacy of companies participating in the sections 7(a) 502, or 503 programs. In the opinion of the Committee, enactment of this bill will not result in additional paperwork requirements for the small business sector of the economy.

V. CHANGES IN EXISTING LAW

In compliance with rule XXVI(12) of the Standing Rules of the Senate, changes in existing law made by the statutory provisions of the bill are as follows (existing law proposed to be omitted is en-

closed in black brackets, new material is printed in italic, and existing law in which no change is proposed is shown in roman):

SMALL BUSINESS ACT

* * * * * * *

Sec. 7(a)(3) No loan under this subsection shall be made if the total amount outstanding and committed (by participation or otherwise) to the borrower from the business loan and investment fund established by this Act would exceed $500,000: *Provided,* that no such loan made or effected either directly or in cooperation with banks or other leading institutions through agreements to participate on an immediate basis shall exceed $350,000: *Provided further, that financings provided under this subsection to State and local development companies pursuant to Title V of the Small Business Investment Act of 1958 shall not be considered when computing the total amount outstanding and committed to a borrower from the business loan and investment fund established by this Act.*

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